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Surviving IRS Examinations and Appeals

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Surviving IRS Examinations and Appeals

Emily A. Parker & Robert D. Probasco

I. INTRODUCTION

This article summarizes the statutory, regulatory and administrative rules and procedures that apply to IRS civil tax examinations and Appeals proceedings, including alternative dispute resolution procedures. The focus of this paper is on field examinations, rather than service center examinations, correspondence examinations, or office examinations. In addition, it attempts to answer some of the basic questions that taxpayers often ask their advisors and representatives when they are the subject of an IRS civil tax examination:

- Why was I selected by the IRS for audit?
- How long will this audit take?
- Why do the agents want all this information, documents, data, etc.?
- Do I have to give the agents all the information, documents, data, etc. they have requested?
- What can the IRS do if I don't cooperate in the audit?
- Can I recover from the IRS the fees and expenses I incur in the audit and in the Appeals proceeding?
- Should I ask for an Appeals conference?

II. UNDERSTANDING THE IRS: MISSION, STRUCTURE AND STRATEGY

IRS Mission: The Stated Mission and the Real Mission RRA '98

Pursuant to the IRS Restructuring and Reform Act of 1998, the IRS Mission Statement was changed to state: "To provide top quality service to taxpayers by helping them to understand and meet their tax responsibilities, and by applying the tax law with integrity and fairness to all."¹ The premise underlying

1. P.L. 105-206 (July 22, 1998) (RRA '98)

this Mission is that providing service, education and guidance to taxpayers will result in improved compliance.

Commissioner Everson

With the arrival of Commissioner Mark Everson at the IRS in 2003, the new operating premise of the IRS became: Service + Enforcement = Compliance. While the IRS Mission Statement was not changed, the emphasis shifted to enforcement. Many people describe this as the "pendulum swinging" between service to taxpayers and enforcement of the tax law. The ultimate goal, however, is to improve taxpayer compliance, since the U.S. income tax system is a self-assessment system.

Organizational Structure: Understand the IRS

IRS Operating Divisions

Four Operating Divisions are responsible for the examination function of the IRS. These Operating Divisions and their areas of responsibility are as follows:

Small Business/Self-Employed (SBSE)

Individuals filing Schedules C, E, F or Form 2106 and all other businesses with assets under \$10 million. In addition to examination of these taxpayers, SBSE also is responsible for Collection, Employment Taxes, Excise Taxes, Estate and Gift Taxes, Bank Secrecy Act and Foreign Bank Account Reporting (FBAR). Headquarters: Lanham, MD (New Carrollton).

Large & Mid-Size Business (LMSB)

All Forms 1120 and 1120-S corporations and Form 1065 partnerships with assets \$10 million or more. LMSB is organized into five Industry Groups: Communications, Technology and Media; Financial Services; Heavy Manufacturing and Transportation; Natural Resources and Construction; Retailers, Food, Pharmaceuticals and Healthcare. Headquarters: Mint Bldg., Washington, DC. (NOTE: Sometimes an SBSE taxpayer is audited by LMSB and vice versa, depending on the nature of the taxpayer and its issues.)

Tax Exempt & Government Entities (TEGE)

All tax exempt entities, including religious/political/public charities, private foundations, and employee retirement plans (public and private); and all government entities, such as state,

local, and Indian Tribes, including tax exempt bonds. TEGE is organized into the following units: Employee Plans (EP), Exempt Organizations (EO), and Government Entities (GE). Headquarters: 17th Street, Washington, D.C.

Wage & Investment (W&I)

Basically, all other taxpayers, i.e., individuals who have only wage and investment income. W&I does not conduct field audits. SBSE normally conducts any field audits of W&I taxpayers. SBSE, LMSB and TEGE employ the revenue agents that audit taxpayer returns. Headquarters: Atlanta, GA.

Other IRS Offices and CI

The following also play a role in IRS examinations and Appeals proceedings:

Taxpayer Advocate Service (TAS)

Sections 7803(c) and 7811 create the position of National Taxpayer Advocate (NTA), establish TAS as an independent entity within the IRS, and provide for Taxpayer Assistance Orders (TAO) by TAS. TAS plays two roles within the IRS.

- (1) TAS assists taxpayers in dealing with the IRS, especially where the taxpayer is suffering or about to suffer a significant hardship as a result of IRS action or inaction. TAS can issue a TAO (pursuant to section 7811 and regulations thereunder) to stop or require IRS action. A TAO can be rescinded by the NTA or the Commissioner or his Deputy.
- (2) TAS and the NTA also propose administrative solutions and legislative changes (through the NTA's Annual Report to Congress) to improve the administration of the tax system and the tax law.

Nine Area Taxpayer Advocate Directors (located geographically) oversee 74 Local Taxpayer Advocates (LTA) who handle specific taxpayer cases in their local offices. When IRS actions and inactions just don't seem correct, fair or reasonable, especially where the IRS is not following applicable published administrative guidance including the Internal Revenue Manual, consider requesting LTA assistance.

Appeals

The Mission of Appeals is to resolve tax controversies, without litigation, on a basis that is fair and impartial to both the Government and the taxpayer, and in a manner that will enhance voluntary compliance and public confidence in the integrity and efficiency of the IRS. Appeals is required to (and does) perform this function independently of the Operating Divisions. The Chief of Appeals reports directly to the Commissioner. Taxpayers may contest IRS compliance actions (proposed deficiencies, denials of claims, collection) administratively by asking for Appeals consideration.

Criminal Investigations (CI)

CI has exclusive jurisdiction to investigate potential criminal violations of the Internal Revenue Code. CI also investigates potential violations of the money laundering and Bank Secrecy laws. CI's strategic programs include Legal Source Tax Crimes, Illegal Source Financial Crimes, and Narcotics Related Financial Crimes.

Office of Chief Counsel – Lawyers for the IRS

Mission

To serve America's taxpayers fairly and with integrity by providing correct and impartial interpretation of the internal revenue laws and the highest quality legal advice and representation for the IRS.

Chief Counsel

The Chief Counsel reports directly to the Commissioner, except that (i) the Chief Counsel reports to both the Commissioner and the Treasury General Counsel on legal advice or interpretation of the tax law not relating solely to tax policy and tax litigation, and (ii) the Chief Counsel reports solely to the Treasury General Counsel on legal advice and interpretation of the tax law relating solely to tax policy.²

2. I.R.C. § 7803(b)(1)-(3). NOTE: The Chief Counsel is, by statute, an Assistant General Counsel of the Treasury.

Structure

All employees of the Office of Chief Counsel report to the Chief Counsel.³ The Chief Counsel lawyers generally work either in the National Office (Associate Chief Counsel) or in the Division Counsel Offices (SBSE, LMSB, TEGE and W&I Division Counsel) or in Criminal Tax Counsel, which supports CI. The Associate Chief Counsel TEGE and CI are also Division Counsel TEGE and CT Tax Counsel, respectively.

(1) Associate Chief Counsel lawyers generally are responsible for drafting published guidance, providing informal advice and Chief Counsel Advice to the field, and issuing technical advice memoranda and private letter rulings.

(2) The Division Counsel lawyers are responsible for advising the Operating Divisions in examinations and representing the Commissioner in the Tax Court. Division Counsel lawyers also provide input to published guidelines, especially published guidance of interest to the Operating Division or CI. While the Division Counsel generally are co-located with the corresponding IRS Operating Division Commissioner or CI Chief, the vast majority of Division Counsel lawyers are in about 48 Counsel field offices located throughout the United States.

Treasury Inspector General for Tax Administration (TIGTA)

TIGTA is part of Treasury, rather than the IRS. TIGTA's function is to audit, investigate and report on the IRS and its people and programs. If you encounter situations involving misconduct by an IRS employee, you should report this to TIGTA. (There are many other entities that also provide "oversight" of the IRS.)

IRS Strategy: The Goals and the Reality

IRS 2005-2009 Strategic Plan

This reflects the "roadmap for IRS operations" developed under the leadership of Commissioner Everson.⁴ There are

3. I.R.C. § 7803(b)(4)

4. www.irs.gov

three broad goals with underlying subsidiary objectives, as follows:

Goal 1 – Improve Taxpayer Service

- Improve service options for the tax paying public.
- Facilitate participation in the tax system by all sectors of the public.
- Simplify the tax process.

Goal 2 – Enhance Enforcement of the Tax Law

- Discourage and deter non-compliance with emphasis on corrosive activity by corporations, high-income individual taxpayers and other contributors to the tax gap.
- Ensure that attorneys, accountants and other tax practitioners adhere to professional standards and follow the law.
- Detect and deter domestic and offshore based tax and financial criminal activity.
- Deter abuse within Tax-Exempt and Governmental Entities and misuse of such entities by third parties for tax avoidance or other unintended purposes.

Goal 3 – Modernize the IRS Through Its People, Processes and Technology

- Increase organizational capacity to enable full engagement and maximum productivity of employees.
- Modernize information systems to improve service and enforcement.
- Ensure the safety and security of people, facilities and information systems.
- Modernize business processes and align the infrastructure support to maximize resources devoted to front-line operations.

Reality: The IRS Annual Budget and the Budget Process

Government Fiscal year – October 1 through September 30

The 2006 Budget year ended September 30, 2006, and the 2007 Budget year began October 1, 2006. However, as has been the case for several years, the IRS is operating under a Continu-

ing Resolution today rather than under the 2007 Budget. When operating under a Continuing Resolution, the IRS can spend essentially what it was allowed to spend under the prior year's Budget. NOTE: An IRS agent or Counsel may say that they cannot travel because they are operating under a Continuing Resolution.

IRS Budget (2003 – 2006) (in Thousands)

Year	Total	Enforcement
2003	9,834,900	3,704,800
2004	10,412,676	6,052,377
2005	10,495,087	6,392,187
2006	10,832,526	6,892,596
2007 ⁵	11,009,107	N/A

(1) Historically, the IRS Budget has been divided into three broad areas: Processing, Assistance & Management (PAM); Tax Law Enforcement (TLE); and Information Systems (IS). Congress also separately budgets Business Systems Modernization (BSM) and sometimes other specific categories, e.g., EITC enforcement. Beginning in 2006, the IRS restructured its budget into a single category: Tax Administration & Operations, which includes programs formerly budgeted in PAM and TLE.

(2) The President's IRS Budget is developed by the IRS working with Treasury and the Office of Management & Budget (OMB). In effect, the Commissioner must support the President's Budget to Congress. Each year, for the last 20 years, with limited exceptions, the President's IRS Budget has exceeded the IRS Budget as enacted by Congress.

THE AUDIT PROCESS

How and Why are Taxpayers Selected for Audit?

Audit Coverage Rates

For all taxpayers (individuals and businesses), audit rates are very low as reflected by the following tables (Source for 2002-2004 Audit Rates: Transactional Records Access Clearing-

5. President's Proposal

house, Syracuse University; IRS AIMS reports and IRS Data Books).

Audits of Individual Income Tax Returns

Year	Rate per 1,000 Returns	
	All Examinations	Rate Excluding Correspondence Exams
2002	5.7	1.6
2003	6.5	1.6
2004	7.7	1.5

Audits of Business Returns

Year	Total Return Filings	Number of Audits	Rate per 1,000 Returns
2002	43,335,200	95,746	2.2
2003	44,041,459	91,352	2.1
2004	45,078,458	86,970	1.9

These statistics are misleading because the IRS does not conduct "random" audits (except possibly for research purposes), so the probability of a particular taxpayer being audited depends on the taxpayer's return, income, status, etc.

2002-2004 Audits of Corporations with Assets of \$250 Million or More

LMSB Industry Areas	Returns Filed	3 Year Audit Rate Average
Financial Services	7,898	15%
Communications, Technology and Media	1,040	64%
Retailers, Food, Pharmaceuticals, and Healthcare	820	81%
Natural Resources and Construction	627	~100%
Heavy Manufacturing and Transportation	592	~100%
Total	11,193	33%

Current Audit Rates

While audit and collection rates fell dramatically between 1998 and 2003, over recent years, the IRS has increased its enforcement activities consistent with Commissioner Everson's

emphasis on enforcement. The following is a summary of selected audit statistic for 2005:

- Audit rate: high income individuals (>\$100,000) – 1.58%
- Audit rate: all individuals – .93%
- Audits of businesses with < \$10 million assets: increased 145% (17,867 audits)
- Audits of businesses with > \$10 million and < \$50 million assets: increased 31.8% (3,539 audits)
- Audits of businesses with > \$250 million assets: increased 11.7% (almost 5,000 audits)
- \$47.3 billion examination collections – 10% increase over 2004 and 40% increase over 2000
- 6% decrease in criminal referrals to DOJ from 2004

Selecting Returns for Audit

NOTE: Much of this information is from the Internal Revenue Manual (IRM). The IRM provides information regarding the organization, administration and operation of the IRS for the use of IRS personnel. It does not create or modify legal rights.

Selection Process

(1) Publication 1 (May 2005) describes the selection process as follows: (i) computers screen returns to match reported information (e.g., W-2's, 1099's, K-1's) to returns; (ii) returns also are selected based on past examinations, issues identified by compliance projects, or examinations of others (e.g., tax shelter promoter audits); and (iii) returns may be selected based on information from outside sources, including newspapers, public records, and informants (e.g., disgruntled employees of taxpayer).

(2) Returns may be classified by computer for examination and then not examined (or selected only for examination of specific issues) after manual review or because the resources to conduct the examination are not available. The type of examination (i.e., survey,

correspondence, office or field) also is determined in this process.⁶

Selection Criteria

Discriminant Function System (DIF)

DIF is a mathematical technique for identifying and selecting returns for examination by assigning weights to various return characteristics to produce a DIF score, and then ranking the returns for examination based on the highest DIF scores.

(a) The following returns are DIF scored: (i) all individual returns; (ii) all corporate returns without a balance sheet; (iii) all corporate returns with assets of less than \$10 million.⁷

(b) The DIF characteristics and their weighting are highly secret, but most observers agree that the following return characteristics are significant: high ratio of deductions to income; salary levels; net operating losses; deductions for repairs; installment sales; corporate reorganizations; appraisals and valuations; depreciation schedules; travel and entertainment deductions; Schedule C returns for wage earning individuals.

Research Examinations

The IRS conducts certain audit programs for the purpose of formulating audit selection techniques and evaluating overall compliance rates, i.e., quantifying the "tax gap." In 2002, the IRS conducted National Research Program (NRP) audits of individual taxpayers for this purpose. Prior to 2002, the last research program of this type was conducted in 1988 and was called the Taxpayer Compliance Measurement Program (TCMP). The TCMP audit

6. IRM 4.1.51. NOTE: If a return is "surveyed" the taxpayer is never contacted. If a return is selected for audit of only a limited issue, the auditor will tend to focus only on that issue, since the time allotted for the audit is based on the scope of the audit.

7. IRM 4.1.3.

program was terminated as a result of complaints about the intrusive nature of TCMP audits. The IRS currently is conducting research examinations directed at S corporations.

Other Sources

Various other sources are used to identify and classify returns for examinations, including the following:

- (1) Taxpayer files a claim for a refund or credit.
- (2) National Office (Associate Chief Counsel Income Tax & Accounting) issues a letter to the taxpayer authorizing a change in accounting method.
- (3) Taxpayer files a section 338 election.
- (4) Examination of a related taxpayer, e.g., a partnership and its partners, a tax shelter promoter and its investors, an S corporation and its shareholders, a corporation and its executive officers and directors.⁸
- (5) Taxpayer files certain forms with its return, such as Form 8283 (Non-Cash Charitable Contributions) or Form 8082 (Notice of Inconsistent Treatment).
- (6) Reportable transaction disclosures either under section 6111 (by material advisor) or under section 6011 (by taxpayer).⁹

Restrictions on Executive Branch

The President, Vice President and any member of the President's Cabinet (other than the Attorney General) are prohibited from requesting (directly or indirectly) any officer or employee of the IRS to conduct or terminate an examination or investigation of any particular taxpayer with respect to the tax liability of that taxpayer, subject to limited exceptions such as a request by the Secretary of the Treasury to implement a change

8. LMSB has announced a program under which it will regularly open examinations of the executive officers and directors of public companies (and sometimes major shareholders) upon audit of the public company. See "Corporate Executive Compliance" at www.irs.gov/businesses/corporations.

9. See Mary A. McNulty & Robert D. Probasco, *Tax Shelter Disclosure and Penalties: New Requirements, New Exposure*, J. Tax'n & Reg. of Fin. Institutions, Jan./Feb. 2005, at 22.

in tax policy. There are criminal penalties for violation.¹⁰ Similar statutory restrictions do not apply to members of Congress, although Congressional ethics rules may prohibit such requests.

Special Audit Programs, Types of IRS Agents and Prefiling Resolution

Special Audit Programs

Inclusion in one of these audit programs will impact the extent and nature of the examination:

LMSB Coordinated Industry Case ("CIC")

These are regular audits of large corporations with complex returns that are conducted by a team of three or more IRS agents.¹¹ In addition to the normal CIC audit process, the IRS has developed special programs applicable to these taxpayers.

Limited Issue Focused Examinations (LIFE)

CIC taxpayers accepted into this program enter into an agreement with the IRS to limit the issues (and refund claims) in the audit usually based on materiality criteria. The IRS and the taxpayer also agree to cooperate in the audit and agree to certain time frames for the audit. The goal is to accelerate audit cycles and close taxable years more promptly. The IRS considers a number of facts in determining whether LIFE is appropriate, including a limited number of material items, the taxpayer's willingness and ability to meet the requirements (e.g., timely responses to Information Document Requests and Notices of Proposed Adjustment), and absence of tax shelter transactions or indications of fraud.¹²

Compliance Assurance Program (CAP) Pilot

LMSB conducted a pilot program for the 2005 tax year for 17 CIC taxpayers. Under the CAP process, the IRS account coordinator works with the taxpayer to resolve issues BEFORE the taxpayer files its return. The goal is to assure both the taxpayer and the IRS that the return as filed is correct and will be

accepted as correct. Therefore, the CAP process is a "prefiling audit," somewhat similar to a prefiling agreement, except the taxpayer does not select the issues to be considered.¹³

Technical Advisor (TA) Program (Formerly Industry Specialization Program)

This is designed to achieve uniform identification, development and resolution of industry-wide tax issues that arise in the CIC Program and the general examination program. See the discussion below of the Industry Issue Resolution Program.

Examination Specialization (ES) Program

Under this program, the IRS assigns limited issues, industry segments, or types of entities to specially trained examiners to obtain knowledge of the issues and taxpayers in order to develop effective specialized examination techniques to apply to the general examination program.¹⁴

Financial Status or Economic Reality Audit Program

The IRS reconstructs taxpayer income based on "life style." These types of audits have been the subject of controversy because they are very intrusive. The IRS is prohibited from conducting these types of audits unless it has "a reasonable indication that there is the likelihood of unreported income."¹⁵

Offshore Compliance Program

This program's focus is primarily on identifying and auditing taxpayers who have offshore accounts and trusts for unreported income. John Doe summonses are regularly used in this program.

Abusive Schemes and Tax Shelter Promoter Investigations

These focus on investigating and enjoining or penalizing promoters of schemes and scams and abusive tax avoidance transactions.¹⁶

10. I.R.C. § 7217.

11. IRM 4.45.

12. See News Release IR-2002-133, Dec. 4, 2002; IRM 4.51.3. Details regarding LIFE are also available at www.irs.gov/businesses.

13. See Ann. 2005-87, 2005-50 I.R.B. 1144. More taxpayers have signed up for the CAP pilot for the 2006 tax year.

14. IRM 4.28.

15. I.R.C. § 7602(e).

16. I.R.C. §§ 6700, 7407, 7408.

LMSB Tax Shelter Initiative and Promoter Investigations

These are audits of promoters who have promoted, and taxpayers who have engaged in, "Listed Transactions."

National Research Program

Discussed above.

Types of Agents

In the course of an examination, a taxpayer may encounter different types of agents who perform different functions:

- a. Tax Auditor conducts office audits.
- b. Revenue Agent is a more experienced agent who conducts field examinations.
- c. Revenue Officer normally specializes in collection of taxes, but may conduct employment tax audits. (Collection is beyond the scope of this article.)
- d. Team Leader is a senior revenue agent who supervises agents on a CIC program audit.
- e. Computer Audit Specialist (CAS) Agent is trained in computer systems and will analyze the taxpayer's computer systems, design programs to select data, participate in record retention reviews and agreements, and arrange for computing resources for the audit.
- f. Engineer Agents and Economists have technical training and usually address valuation or transfer pricing issues.
- g. International Examiners (IE) have specialized training in international tax issues and, if assigned to the audit, are responsible for those issues in an audit.
- h. Special Agents are criminal investigators from CI. (Criminal tax investigations are beyond the scope of this article. However, taxpayers and their advisors should be aware of the risk that a civil examination may become a criminal investigation. Fraud referral specialists working for the IRS Operating Divisions may assist an agent in determining whether to refer a case to CI.)
- i. Other types of specialized agents include estate and gift tax agents (usually a lawyer), excise tax agents, and employment tax agents, all of whom work in

SBSE; and pension trust examiners who work in TEGE.

Profiling Resolution Programs

Market Segment Understandings (MSU)

These are voluntary compliance agreements designed and implemented on an industry-by-industry basis to assure tip reporting compliance. For example, such understandings exist for the food and beverage industry, the gaming industry.¹⁷

LMSB Industry Issue Resolution (IIR) Program

The IIR Program resolves frequently disputed or burdensome tax issues that affect a significant number of business taxpayers. The IRS solicits suggestions for issues from taxpayers, taxpayer representatives and associations for the IIR Program. For each issue selected for the program, a resolution team of IRS, Chief Counsel and Treasury personnel is assembled to gather and analyze relevant information for the issue and develop and recommend published guidance.

Other Pre-filing Resolution Techniques

Private Letter Rulings (PLR)

Except for certain rulings and determinations issued by TEGE, these rulings are issued to taxpayers regarding proposed transactions by the Associate Chief Counsel Offices.¹⁸

Advance Pricing Agreements (APA)

The APA Office resides in the Office of the Associate Chief Counsel (International). Lawyers and economists in that office work with the IRS Operating Division and the Director International (U.S. Competent Authority) to resolve transfer pricing issues under section 482 by entering into unilateral (U.S. only) and bilateral (U.S. and foreign government) agreements with taxpayers.¹⁹

17. (Rev. Proc. 2003-35, 2003-1 CB 919), cosmetology and barber industry, and limousine industry. These tip agreements are available at www.irs.gov/business/small.

18. See Rev. Proc. 2006-1, 2006-1 IRB 1.

19. See Rev. Proc. 2006-9, 2006-2 IRB 278.

Pre-filing Agreements (PFA)

Upon request and acceptance, taxpayers may enter into PFA's before filing their returns to resolve specific issues for current year and up to four subsequent years.²⁰

Preparing for the Audit

Retention of Representative and Conflicts

Power of Attorney

Representative must be authorized to practice before Treasury and also must be authorized to represent the taxpayer in the specific matter. Therefore, the representative must provide the IRS a Power of Attorney (Form 2848) duly executed by the taxpayer. NOTE: The IRS will reject a Power of Attorney unless it is completed, signed and dated in accordance with its requirements.

(1) If the scope of the representation is limited to receiving information from the IRS, then Form 8821, Tax Information Authorization, would be sufficient. To "represent" a taxpayer in an audit, a Power of Attorney is required, although the scope of the Power may be limited by specifically excluding certain powers.

(2) Even if the Power of Attorney grants the holder the authority to execute agreements (such as extensions of the statute of limitations, etc.) on behalf of the taxpayer, it is recommended that, in most cases, the taxpayer sign such substantive agreements, if possible.

Right to Practice

(1) Any attorney or certified public accountant licensed and in good standing under the laws of any State is authorized to practice before the IRS, unless disbarred under Circular 230, 31 C.F.R. Subtitle A, Part 10. Enrolled agents and enrolled actuaries also may practice before the IRS. Individuals who represent their employer before the IRS also have the limited right to practice before the IRS on behalf of their employer.

(2) Circular 230 provides that the Treasury may suspend or disbar a practitioner upon a showing of incompetence, disreputable conduct, refusal to comply with the Rules of Practice, or

that the practitioner, with intent to defraud, willfully and knowingly mislead or threatened a client or prospective client.²¹

(3) Disreputable conduct, as defined in Circular 230, § 10.51, includes:

- Giving opinions which reflect or result from assertion of a position known to be unwarranted under existing law.
- Giving a false opinion, knowingly, recklessly, or through gross incompetence or which is intentionally or recklessly misleading.
- Conviction of any criminal offense under federal revenue laws or of any offense involving dishonesty or breach of trust.
- Willful failure to file a federal tax return or willful evasion or attempted evasion of, or advising a client to evade federal taxes or the payment thereof, or concealing assets to evade federal taxes or their payment.

(4) As a matter of practice, cases involving penalties imposed under sections 6694 (return preparer), 6700 (promoting abusive tax shelters), or 6701 (aiding and abetting understatement) and injunctions under sections 7407 or 7408 are referred to the Office of Professional Responsibility for consideration of disciplinary proceedings.

Conflicts

Circular 230, § 10.29 prohibits a practitioner from representing conflicting interests in practice before the IRS without express consent of all directly interested parties after full disclosure. Section 10.29 expressly states that this "informed consent" must be "confirmed in writing" and must be retained for 36 months from the date of conclusion of the representation and provided to the IRS upon its request. Conflicts of interest often arise where the practitioner advised or opined regarding a transaction or return position or prepared the subject return, especially if there is the possibility of a penalty or that the practitioner would be a witness in the matter. NOTE: Under Proposed Amendments to Circular 230, any consent to a

20. See Rev. Proc. 2005-12, 2005-3 IRB 311.

21. Circular 230, § 10.50.

practitioner's representing conflicting interests must be signed by the consenting taxpayer.

Witnesses before IRS

Any person may be a witness to explain the taxpayer's books, records or returns to the IRS in the course of an examination. A witness is not a "representative" and does not have to be qualified to practice before the IRS. IRM 4.11.55.1.2.

Identify, Evaluate and Address Potential Issues and Problems

Who should represent the taxpayer in the audit?

- Taxpayer personally or taxpayer's employees.
- Tax return preparer.
- Representative: Lawyer, CPA, enrolled agent.

The answer depends on the nature of the audit, expected issues, who is available, the relationship with the agent, and what the agent potentially will "think" about that representative. For example, will representation by a lawyer cause the agent to become defensive/suspicious? What if the lawyer is a known criminal tax lawyer?

Where and when will the audit be conducted?

- Audits normally are conducted in the area where the taxpayer resides or conducts business or maintains a principal office. NOTE: Any request to change the area of the audit should be made immediately upon receipt of notice of initiation of the examination, although a taxpayer may request a transfer at any time during the audit.
- If the taxpayer no longer resides or maintains its books and records in the area where the return was filed, the IRS normally will grant a request to transfer the examination to the new area.²²
- The IRS normally does not grant requests to change the area of the audit if the period of limitations will expire within 13 months of the request for transfer,

22. Treas. Reg. § 301.7605-1(e). For factors the IRS considers in granting requests for transfer, see IRM 4.10.2.8.3(4).

unless the taxpayer agrees to extend the limitations period for up to one year.²³

- The examination must be conducted during normal working hours and at a reasonable time and place.²⁴
- If an audit would disrupt a small business or force it to close, the IRS will change the location of the field examination.²⁵ But the IRS has the right to visit the taxpayer's residence or place of business if necessary to conduct the audit.
- The taxpayer may request that the audit be conducted at the tax preparer's or representative's offices. Such requests are granted at the "sole discretion" of the IRS, but such requests are frequently granted.²⁶
- The IRS reserves the right to determine the time and place of the audit, taking into account its resources and examination efficiency. NOTE: The IRS determinations should be reasonable, but the IRS has broad legal authority to conduct examinations where it chooses.
- CIC audits normally are conducted on the taxpayer's premises. Most CIC taxpayers provide their audit teams with permanent space to conduct audits for the convenience of both the IRS and the taxpayer.

Are there any limitations on the right of the IRS to audit?

- Sections 7601 and 7602 state broad IRS authority to audit and to issue summonses to taxpayers and other persons for books, papers, records, other data and testimony that may be relevant or material to any examination.
- An individual may object to "repetitive" audits.²⁷ The IRS still has the discretion to audit.
- Section 7605(b) prohibits a second examination of a taxpayer return for a taxable year unless written no-

23. Treas. Reg. § 301.7605-1(e)(4).

24. See Treas. Reg. § 301.7605-1.

25. Treas. Reg. § 301.7605-1(d)(3)(ii).

26. Treas. Reg. § 301.7605-1(e)(3).

27. See IRM 4.10.2.4.2.4 (audited for one of two prior years with no change or minor change).

tice is provided by the IRS.²⁸ The taxpayer must assert this objection upon initiation of the audit, or it may waive the objection.²⁹

- Treas. Reg. § 601.105(j) describes generally when the IRS will reopen a case closed after examination.

What are the potential issues that will arise in the course of the audit?

Consider fact issues, procedural issues, privilege issues, legal issues, responses to information, document and interview requests, and potential third party contacts. Specific actions and areas of concern include:

- Review prior IRS audits and results (if applicable) to determine "carryover" issues, as well as loss or credit carryovers and carrybacks.
- Review all correspondence between the IRS and the taxpayer regarding the proposed (or existing) audit.
- Review tax returns to determine what is disclosed or not disclosed. Consider voluntary disclosure of issues by CIC taxpayer to avoid penalties.³⁰
- Review audited financial statements, tax return workpapers and tax accrual workpapers (if applicable) to identify and understand potential issues.
- Consider automatic change of accounting method possibility/issues.³¹
- Discuss return positions and support with tax return preparer, existing advisor, and person(s) that provided information for the return or the tax accrual.
- Identify sources for pertinent files and records and persons with knowledge of facts and issues.
- Identify and mark as "privileged" or "work product" any files that contain protected communications, i.e., attorney-client privilege, work product, and section 7525 (federally authorized tax practitioner privilege). Store these files separately.
- Identify and evaluate potential issues, both fact and legal.

28. Rev. Proc. 96-68, 1994-2 C.B. 803 (procedures for reopening closed cases).

29. *Rice v. Comm'r*, 67 T.C.M. (CCH) 2921 (1994).

30. See Rev. Proc. 94-69, 1994-2 C.B. 804.

31. See, e.g., Rev. Proc. 2002-9, 2002-3 IRB 327.

- Identify books and records, documents and files and other information and data needed to support return.
- Educate yourself regarding the taxpayer's file indexing, storage, retention and retrieval policies and systems.
- Identify person(s) with knowledge of events relevant to potential issues. NOTE: Special problems arise for deceased individuals and former employees (especially disgruntled former employees).
- Consider the possibility of a penalty and what defenses taxpayer may present to penalty, e.g., reliance on tax professional, and impact on claims of privilege. NOTE: The possibility of a penalty will raise concerns by the advisor or return preparer of possible malpractice claims. It may be appropriate to advise the taxpayer to seek a "tolling agreement" with the advisor or tax return preparer to extend the statute of limitations on any such claims.
- Consider whether there are potential claims for refund that should be pursued.
- Determine who will make any computations or re-computations required, including interest calculations. NOTE: Statutory provisions regarding interest on tax underpayments and overpayments are very complex and any computations should be reviewed carefully.³²
- What issues or adjustments can we expect the IRS to pursue?
- IRS Audit Technique Guides (ATG)
- ATG contain examination techniques, common and unique industry issues, business practices, industry terminology and other information to assist the IRS examiner in performing examinations. ATG will indicate what issues the audit team might pursue and their approach to the issues.
- LMSB Coordinated Issue Papers (CIP)
- CIP are issued by LMSB following review by the Office of Chief Counsel. They set forth the IRS's current thinking on complex and significant industry-

32. See Mary A. McNulty, David H. Boucher, Joseph M. Incorvaia, and Robert D. Probasco, *Computing Interest on Overpayments and Underpayments: How Difficult Can It Be? Very!*, 102 J. Tax'n 273 (May 2005).

wide issues and provide guidance to field examiners to ensure uniform application of the law. (These papers are not official pronouncements or published guidance on the issue, but they will describe the IRS position in some detail.)

- LMSB Industry Director Guidance (IDG)
- These directives provide administrative guidance to LMSB examiners on specific issues. They are issued by the Industry Directors and are not legal guidance and do not establish the IRS position on legal issues. (These are not reviewed by the Office of Chief Counsel, although Division Counsel lawyers may provide input.)

NOTE: ATG, CIP and IDG are available at www.irs.gov. Those relevant to the audit should be reviewed before the start of the audit.

I did not correctly report my income on my return as filed. Do I have to amend my return or disclose this mistake to the auditor?

- Circular 230, § 10.21 provides that when a practitioner representing a taxpayer before the IRS knows that the client has not complied with the revenue laws or has made an error or omission from any return, document, affidavit or other paper submitted to the IRS, the practitioner must advise the client of the noncompliance, error or omission and advise the client of the consequences under the Code and regulations of such noncompliance, error or omission.
- A taxpayer may file a "qualified amended return" and the additional tax reflected on that return is treated as shown on the original return for penalty purposes, unless it relates to a fraudulent position on the original return.³³
- A "qualified amended return" must be filed before the earliest of: (i) the taxpayer is first contacted by the IRS concerning an examination (including a criminal investigation) regarding the return; (ii) a person is contacted regarding an examination under

section 6700 (penalty for promoting abusive tax shelters) for an activity with respect to which the taxpayer claimed a tax benefit (even if the promoter penalty is not sustained); (iii) for a pass-through item, the pass-through entity is first contacted in connection with an examination; (iv) the IRS serves a John Doe summons (section 7609(f)) relating to a person, group or class that includes the taxpayer; or (v) the IRS announces a settlement initiative to compromise or waive penalties with respect to a listed transaction.³⁴

- If a CIC taxpayer complies with Rev. Proc. 94-69, 1994-2 C.B. 804, it may submit a disclosure statement for errors and omissions after commencement of the examination of its return, and that disclosure will be treated as a "qualified amended return" for purposes of avoiding accuracy related penalties, subject to certain limitations. In general, this written disclosure must be made within 15 days after the IRS makes a written request.
- If the error is use of an improper method of accounting, special rules apply and a taxpayer may be able to request an automatic change in a method of accounting. The taxpayer may avoid deficiencies in prior years and penalties if the request is filed within certain periods and before the issue is under examination.³⁵
- In any event, the question whether to disclose errors and omissions presents difficult choices for both the taxpayer and the practitioner who would represent the taxpayer before the IRS in the audit. The considerations bearing on these choices include: (i) can the taxpayer automatically avoid penalties by making a disclosure, (ii) would disclosure reduce the likelihood of the IRS imposing a penalty, (iii) assuming the error or omission is clear, can the practitioner not disclose the error or omission without making misrepresentations and misleading statements to the IRS, and (iv) is the taxpayer going to be required

33. Treas. Reg. § 1.6664-2T(c)(2)

34. Treas. Reg. § 1.6664-2T(c)(3).

35. See Rev. Proc. 2002-9, and other Revenue Procedures providing for changes in accounting methods in specific circumstances.

to disclose the error for financial statement purposes.

- If the noncompliance, error or omission is absolutely clear (there is no basis for argument), we would advise our client to disclose the item to the IRS, although we would also advise the client that it is not required to do so. We would not necessarily refuse to represent a client who decided not to voluntarily disclose, if we concluded that we could represent them without making misrepresentations or misleading statements to the IRS. When making this decision, however, remember that "life is short."
- If the taxpayer has made a clear error or omission or has engaged in transactions that the practitioner knows the IRS will question, there should be a clear understanding with the client at the commencement of the audit regarding the obligation of the practitioner and the taxpayer to respond truthfully to IRS requests for information or documents. Don't wait until the IRS asks about these matters to have this discussion with your client.

Protecting Required Documents and Information

Retention Policies

Many taxpayers have file retention policies. If those policies exist, they should be reviewed to determine if they are broad enough to protect the files required and whether a "freeze" on destruction should be issued. Also, determine if such policies are being enforced. NOTE: Taxpayers often have retained documents that should have been destroyed under their document destruction policy so don't assume that documents required to be destroyed have been destroyed. Also, failure to comply with the formal policy and retaining documents past the scheduled destruction date may create negative implications with respect to other documents which WERE destroyed.

Protecting Documents

If the taxpayer does not have a file retention policy, then establish and communicate such a policy for files pertinent to the audit and potential issues in the audit. For many individuals and small businesses, it may be advisable to collect the relevant files to assure that they are protected and accessible.

- Where international issues or foreign clients are involved, it is advisable to determine if the file retention policies in the foreign country are sufficient and whether those files are accessible. See the discussion below of Formal Document Requests pursuant to section 982.
- Consider whether documents and taxpayer information in the hands of third parties (e.g., appraisers, consultants, lawyers, accountants, banks) should be accessed and preserved.
- Identify a point person employed by the taxpayer to identify, protect, obtain and supply documents and information.
- Evaluate the taxpayer's system for identifying and protecting privileged communications.

The Basic Audit Process

Initial Conference and Audit Ground Rules

Initial Conference

All persons to be involved in the audit for the taxpayer and the IRS should attend the initial conference. All members of the IRS audit team normally will attend, so this is an opportunity to determine who will be involved, what their roles will be, and the nature of the planned audit, as well as to evaluate the IRS agent or team. NOTE: This likely will be a "meet and greet" meeting.

Ground Rules

Ground rules for the audit should be discussed with the IRS agent or team. Depending on the type of taxpayer and type of audit expected, the areas to discuss include:

- Timetable for the audit: Starting date and projected completion, although the IRS cannot be bound to this timetable. The starting date is particularly important for timing of disclosures in CIC cases and for requests for automatic changes in accounting methods. The projected completion date is also important because the auditor will feel pressure to close the audit "on time," especially due to increased emphasis on the number of audits performed and improved audit currency.

- **Contact person:** A contact person for the taxpayer and for the IRS should be identified. Other persons should be instructed not to respond to requests from the IRS, except as directed by the contact person. See the discussion below of taxpayer interviews.
- **Facilities/location:** The taxpayer (especially in CIC cases) often provides the IRS audit team with office space and furniture, telephones and other equipment. **NOTE:** The IRS audit team should either be isolated from the taxpayer's business offices or adequate controls and rules should be established so that IRS contact with the taxpayer's personnel (formal and informal) is limited.
- **Copying:** To assure that the taxpayer has a copy of all documents obtained by the IRS, the taxpayer often will not allow the IRS to make copies, but will have an employee of the taxpayer make copies for both the IRS and the taxpayer. **NOTE:** Identification, retention and access to all documents and information provided to the IRS is a major logistical problem in CIC audits. Document imaging, numbering and indexing systems may be worth the investment, although the IRS will request large volumes of documents and information that the taxpayer will never need to access again.
- **Computer data:** Understand what information is available to the IRS through access to the taxpayer's computerized data.
- **Information Document Requests (IDR), Form 4564:** It is common practice (especially in CIC audits) to require the IRS to put all requests for information and documents into writing and to respond in writing. In any event, the taxpayer should make and retain a record of all requests, the date of the request, the response, the date of the response, and the source of the response.
- **Extensions of the statute of limitations:** The taxpayer's policy regarding extensions of the statute of limitations should be discussed/explained, especially if the taxpayer has a policy of not extending the statute. Disclosure of this policy at the commencement of the audit will reduce IRS "angst" later from an unexpected refusal to extend the statute.

- **IRS use of consultants:** Determine if the IRS plans to use consultants who are not IRS employees. Ground rules for sharing taxpayer information with consultants should be discussed and agreed, especially if trade secrets are involved. **NOTE:** The IRS by contract will require consultants to comply with section 6103, which prohibits the public disclosure of taxpayer and tax return information subject to criminal penalties.
- **Refund claims:** Timing of refund claims should be discussed and agreed. Taxpayers often do not know of refund claims until late in the audit. **NOTE:** IRS agents seem to believe that taxpayers intentionally hold refund claims until late in the audit.
- **Explore whether this audit is part of a special audit program, e.g., NRP, ES, TA, Offshore Compliance, Tax Shelter, or Financial Status.**
- **Inquire about and negotiate the auditor's third party contact policy, plans and notice policy.** See the discussion below of third party contacts.

Responding to IRS Requests During the Audit

Recordkeeping Requirements

- (1) Taxpayers are required to maintain and retain books and records adequate to establish their tax liability as long as they may be material to administration of any internal revenue laws, and the IRS is authorized to examine any such books and records.³⁶
- (2) Special rules and requirements apply to certain types of records, including:
 - Records of controlled foreign corporations.³⁷
 - Automatic data processing systems and electronic storage systems.³⁸
- (3) If the taxpayer fails to maintain required records, the IRS may issue a Notice of Inadequate Records.³⁹ The taxpayer may also be subject to the accuracy-related civil penalty or even, if the failure is considered willful, criminal penalty.⁴⁰

36. I.R.C. § 6001; Treas. Reg. § 1.6001-1.

37. I.R.C. § 6038A.

38. Rev. Proc. 97-22, 1997-1 C.B. 652; Rev. Proc. 98-25, 1998-1 C.B. 689.

39. Treas. Reg. § 1.6001-1(d).

40. Treas. Reg. § 1.6662-3(b)(1); I.R.C. § 7203.

Information Document Requests.

(1) Requests for information and documents in the course of an examination are usually reflected in an IDR. Normally, it is not productive to refuse to comply with an IDR. See the discussion below of IRS summons power. The taxpayer is not required to create documents and information that does not exist in order to respond to an IDR, but a taxpayer may want to organize information for the IRS.

(2) A taxpayer may question and negotiate where the IDR is unclear, overly broad, or imprecise. There are two different practical responses to these types of IDR's:

- Object and demand clarification or limitation of the request before responding. This approach provides certainty as to the scope and nature of the IRS request, so that the taxpayer does not provide information that the agent does not actually want. The taxpayer also can demonstrate that it has complied with a focused and precise request. However, this approach may cause the IRS to improve or even expand its request.
- Some imprecise and overly broad requests can be interpreted by the taxpayer in a manner that limits the scope of the required response. That is, the taxpayer may just interpret the request reasonably. If the taxpayer takes this approach, the response should specifically state what is being provided and that all records requested are not being provided. This approach can backfire if the taxpayer provides information that is not really wanted by the agent, or if the IRS considers the taxpayer to be uncooperative or not responding promptly or properly to the IDR.

(3) The best policy is to have a forthright dialogue between the IRS and the taxpayer as to (i) what the agent wants and why it is needed; and (ii) what information is available, when it can be provided, the cost to provide, and how it can be accessed and used efficiently.

If the IRS does not ask for documents and information, the taxpayer is not obligated to provide. There may be situations, however, where the failure to state a fact could be "misleading."

Caution: Even a closing agreement will not protect a taxpayer if the taxpayer has misrepresented facts to the agent. Representatives also must consider their duties under Circular 230.

NOTE: Both the taxpayer and the representative must always tell the truth, but the IRS (auditors and Appeals officers) are not a "tribunal" so a lawyer representative is not required to disclose contrary legal authority.

(4) Where a taxpayer fully cooperates in an audit, the burden of proof may shift to the IRS with respect to an adjustment. See the discussion below of requirements under section 7419 for shift of burden of proof.

(5) Circular 230, § 10.20 requires a practitioner (i) to promptly respond to proper and lawful IRS requests for records and information in matters before the IRS, unless the practitioner in good faith believes on reasonable grounds that the requested records and information are privileged (§ 10.20(a)), and (ii) if requested records or information are not within the practitioner's or his or her client's possession, to ask the client to identify the person(s) in possession of the records or information and to identify those person(s) to the IRS (§ 10.20(b)). See the discussion below of third party contacts.

Taxpayer Interviews

Section 7521 provides special rules for interviews of taxpayers by IRS employees, including:

Recording of Interview

Both the taxpayer and the IRS may record any in-person interview of the taxpayer upon 10 days notice of request to record.⁴¹

Representation of Taxpayer

- The taxpayer may be represented in an interview by a practitioner.
- The IRS cannot require the taxpayer to attend the interview unless it is pursuant to an administrative summons.⁴²
- The IRS may bypass a taxpayer's representative and request information from the taxpayer where the

41. For other requirements, see I.R.C. § 7521(a).

42. I.R.C. § 7521(c).

IRS determines that the representative is unreasonably delaying or hindering the examination and notifies the taxpayer.⁴³

Taxpayer's Rights at Interview

- The taxpayer's representative has the right to be present when the taxpayer is interviewed or requested to provide information in connection with an examination.⁴⁴ NOTE: Section 7521 does not apply to criminal investigations, but targets of criminal investigations have a right to counsel under the broader criminal rule.
- In a taxpayer interview, the IRS agent must explain the examination and appeal processes and collection processes to the taxpayer.⁴⁵
- In a taxpayer interview (other than pursuant to an administrative summons) the taxpayer may suspend the interview to consult with his representative.⁴⁶ NOTE: If the agent believes that the taxpayer is abusing this privilege or using it to delay the interview, the agent will issue an administrative summons.
- Where a taxpayer is interviewed pursuant to an administrative summons, he must appear personally and cannot suspend the interview to consult with his representative.⁴⁷

Third Party Contacts

IRS Right

The IRS may contact third parties during an audit to obtain information relevant to the examination without the taxpayer's permission and the taxpayer has no right to be present during such contacts. The IRS must give the taxpayer advance notice that it may contact third parties, but this advance notice need not identify the persons to be contacted.⁴⁸

43. I.R.C. § 7521(c); Treas. Reg. § 601.506(c).

44. I.R.C. § 7521(c).

45. I.R.C. § 7521(b).

46. I.R.C. § 7521(b)(2).

47. I.R.C. § 7521(c).

48. See generally I.R.C. § 7602; Treas. Reg. § 301.7602-2.

Notice of Contacts

The IRS is required periodically to provide the taxpayer with a record of the third parties contacted. Taxpayers also may request that the IRS provide the taxpayer with a list of third party contacts with respect to the taxpayer. NOTE: In the absence of such a request, the IRS probably will not provide the taxpayer with such a list.

Exceptions to Notice

The IRS is not required to provide either advance notice of third party contacts or a list of those contacts in criminal investigations, jeopardy collections, if the disclosure may involve reprisal against the third party, or if the taxpayer authorizes the contact.

Restrictions on Dealings with Third Parties

Circular 230, § 10.20(c) prohibits a practitioner from interfering or attempting to interfere with proper and lawful IRS requests for records or information, unless the practitioner in good faith believes based on reasonable grounds that the requested information is privileged. A practitioner may ask to participate when a third party meets with the IRS or ask the third party to provide information provided to the IRS (such a request is best directed to the third party's lawyer). Don't ask them to refuse to cooperate, unless it is an improper or unlawful request or the taxpayer has bona fide privilege claims.

IRS Administrative Summons and Formal Document Requests

IRS Summons Authority

When Used

An IRS administrative summons to the taxpayer or a third party normally is issued only after the agent attempts to obtain the information voluntarily. Situations in which IRS agents will consider issuing a summons include:

- No records are available to conduct an adequate examination in reasonable time.
- Records submitted are known or suspected to be incomplete and additional records are in the hands of the taxpayer or third party.

- The taxpayer indicates that he is intentionally withholding records for use in Appeals or after notice of deficiency.
- The agent wishes to obtain testimony under oath as to what records exist and their location. IRM 25.5.1.4.

Enforcement

IRS summonses are not self executing. If the summoned party does not comply, the government must bring an enforcement action in the federal district court and obtain an enforcement order. In the absence of valid claims of privilege, i.e., attorney-client, work product or section 7525, courts enforce IRS summonses if:

- There is a legitimate purpose for the IRS examination.
- The information requested may be relevant to that purpose.
- The requested information is not already in the possession of the IRS.
- The IRS has complied with the administrative steps required in the Code and regulations.⁴⁹

Special Types of IRS Summonses

Third-Party Summonses⁵⁰

- Subject to certain exceptions, the taxpayer has a right to notice of the summons.
- If the taxpayer has right to notice, taxpayers may intervene to quash the summons.
- Statute of limitations is tolled during period the taxpayer pursues action to quash a summons.
- Statute of limitations is suspended after 6 months of service if response is not resolved.

Designated Summons⁵¹

- Issued 60 days before expiration of statute of limitations to CIC taxpayer.

- Statute is tolled until the taxpayer complies with the summons.
- The IRS also can issue a related summons to a party that has information relative to the corporation that is the subject of the designated summons.
- The IRS is not required to demonstrate that the taxpayer has been uncooperative in the examination to issue and seek to enforce a designated summons.

Summons for Computer Software⁵² ***John Doe Summonses***⁵³

A John Doe summons does not specifically identify the taxpayer under potential examination. It is served on a party other than the taxpayer only upon approval by a federal district court. The IRS must establish that:

- The summons relates to the investigation of a particular person or group or class of persons.
- There is reasonable cause to believe that the person or group or class may fail or may have failed to comply with the tax law.
- The information sought, and the identity of the persons with respect to whose liability the summons is issued, are not readily available from other sources.

A John Doe summons is typically served, for example, on tax shelter promoters to identify the investors in the shelter.

Formal Document Requests, I.R.C. § 982.

- The IRS makes a formal request for documents.
- If the taxpayer fails to supply the documents within 90 days, it cannot use them in any court proceeding.
- There is a reasonable cause exception for failure to supply.
- Reasonable cause cannot be based on foreign nondisclosure law.
- The taxpayer can seek to quash a formal document request and the statute of limitations is tolled during action to quash.

49. *United States v. Powell*, 379 U.S. 48 (1964) (the "Powell standards").

50. I.R.C. § 7609.

51. I.R.C. § 6503(k); Prop. Reg. § 301.6503(j).

52. I.R.C. § 7612.

53. I.R.C. § 7609(f).

Selected Procedures, Issues or Problems

Technical Advice and Technical Expedited Advice Memoranda (TAM and TEAM)

See Rev. Proc. 2006-2, 2006-1 IRB 89. These are advice from the Associate Chief Counsel (ACC) Office that establishes the IRS legal position in a specific case with respect to the technical or procedural issue presented. These are generally requested by the field office when there is a lack of uniformity regarding an issue, or when one is particularly unusual or complex. (TEAM's are just expedited TAM's that were issued in limited circumstances. As discussed below, these have since been eliminated.) Taxpayers have a right to participate in a TAM or TEAM. TAM's and TEAM's are reviewed and approved at high levels.

The Office of Chief Counsel has announced changes in the way it will provide formal written legal advice to IRS personnel. The existing TAM procedures have been streamlined to provide more timely response and TEAM's have been eliminated. Two new vehicles for legal advice will be available: Case-Specific Legal Advice memoranda (somewhat similar in purpose to the Field Service Advice memoranda used in prior years and discussed below) and General Legal Advice memoranda. See Chief Counsel Notice 2006-013 (May 15, 2006) at www.irs.gov.

Chief Counsel Advice (CCA) flk/a Field Service Advice (FSA)

These are advice from the ACC Office that assists, but does not bind, the examining agent with respect to issues in a specific case. A CCA is normally reviewed and approved at relatively lower levels. The taxpayer does not have a right to participate in consideration and issuance of a CCA. (FSA's, as such, have been eliminated, but ACC continue to provide CCA's to the field.) A CCA must be disclosed to the public, subject to the exceptions in section 6110(c) and applicable privileges.

Requests for Tax Accrual Workpapers

Policy of Restraint

The IRS does not request tax accrual workpapers or audit workpapers from the taxpayer or from its independent accounting firm as a normal audit practice unless "unusual" circum-

stances exist.⁵⁴ The IRS also will request tax accrual workpapers in certain circumstances where the taxpayer has participated in "listed transactions."⁵⁵

Attorney-Client Privilege Issues

The IRS takes the position that attorney-client privilege and the section 7525 privilege do not apply to tax accrual workpapers.⁵⁶

No Accountant Privilege

United States v. Arthur Young & Co., 465 U.S. 805 (1984) holds that there is no accountant privilege for tax accrual workpapers.

Establishing and Protecting Privileges

Requests for Privileged Communications

(1) IRS policies do not prohibit an agent from asking for tax advice that the taxpayer received. The IRS likely can obtain such documents unless they are protected from discovery by the attorney-client, work product or section 7525 privileges. (The substantive requirements for establishing these privileges are beyond the scope of this article.)

(2) Independent auditors are now regularly asking companies for all legal and tax advice that they have received on issues impacting the taxpayer's tax accrual. Providing any privileged communications to a company's independent auditors likely will waive any attorney-client or section 7525 privileges. By contrast, waiver of work product immunity results only if the protected document is shared with an adverse party, and there is conflicting authority on whether an independent auditor is "adverse" for this purpose.⁵⁷

(3) If the IRS requests documents or information that the taxpayer in good faith considers to be privileged, the taxpayer must either claim privilege or waive privilege. To claim privilege the taxpayer should provide a privilege log that gives the

54. IRM 4.10.20.3.1(2), 7.6.2.3.1.

55. Ann. 2002-2, 2002-2 IRB 304.

56. Ann. 2002-63, 2002-27 IRB 72. *But see United States v. Rockwell Int'l*, 897 F.2d 1255 (3d Cir. 1990).

57. *Compare Medinol, Ltd. v. Boston Scientific Corp.*, 214 F.R.D. 113 (S.D.N.Y. 2002) (waiver) with *Merrill Lynch & Co. v. Allegheny Energy, Inc.*, 229 F.R.D. 441 (S.D.N.Y. 2004) (protected).

IRS sufficient detail to show that the documents are privileged. NOTE: The IRS resists "limited waiver of privilege" agreements with taxpayers. This policy forces taxpayers to make difficult decisions about "subject matter" waiver issues, and, as a result, likely limits the IRS's access to documents. Even if the IRS agrees to a limited waiver of privilege by the taxpayer, the DOJ Tax Division may not consider itself bound by such agreement.

(4) Broad claims of privilege are dangerous for a variety of reasons, including:

- Once a taxpayer claims that a document is privileged, there is a greater risk of "waiver" if the document has been or is disclosed.
- Both the IRS (and courts) are suspicious of large volumes of privileged communications.
- The burden of identifying, claiming and protecting large volumes of privileged documents.
- The risk that claims of privilege will appear frivolous.

(5) Widespread IRS attacks on privilege ultimately undermine taxpayer compliance (main IRS goal) for a variety of reasons:

- Taxpayers will not consult tax professionals to get tax advice.
- Taxpayers will not provide their tax advisor with "full and frank" communications.
- Tax advisors will not provide detailed written tax advice that describes all tax risks to the client.
- NOTE: Tax advice may not provide the taxpayer with "penalty protection" in these cases, but that is not the purpose of most tax advice. Most taxpayers request tax advice to comply with the law, albeit by paying the lowest tax required by the law.

Work Product

(1) Work product protection applies to documents and things prepared in anticipation of litigation. Work product protection is not absolute, except for mental impressions and views of a lawyer.⁵⁸

58. See *Hickman v. Taylor*, 329 U.S. 495 (1947); Fed. R. Civ. Proc. 26(b)(3).

(2) In general, materials created or gathered by IRS agents in an examination are not work product since they are not prepared in anticipation of litigation.⁵⁹ However, documents prepared by IRS agents and Appeals officers are protected if prepared for IRS Counsel in anticipation of litigation.⁶⁰

(3) An imaged document collection and indexing system (that includes documents selected by an attorney) may not be protected work product, if the selected documents and the index do not reveal the lawyer's mental impressions. See *Hambarian v. Comm'r*, 118 T.C. 565 (2002). The Tax Court emphasized that there were over 100,000 documents selected so the collection would not disclose the attorney's mental impressions. NOTE: This system was work product but it was not protected because it did not reflect the attorney's mental processes.

Discovery from the IRS

FOIA and Privacy Act

(1) Freedom of Information Act, 5 U.S.C. § 552: FOIA requires government agencies to make available to the public materials that they gather and maintain, subject to a number of exceptions. For the IRS, these exceptions include section 6013.

(2) Privacy Act, 5 U.S.C. § 552a: Subject to specified exceptions, the Privacy Act of 1974, as amended, prohibits government agencies from disclosing information about a person unless that person consents. (Section 6103 provides additional limitations on the IRS.) The Privacy Act also grants a person the right to review certain records maintained by the government with respect to that person.

Privileges

(1) Attorney-client and work product privileges apply to the IRS and will be claimed.⁶¹

(2) Deliberative process (executive) privilege also applies to the government. Treas. Reg. § 301.9000-2(b)(3). NOTE: This privilege applies to pre-decisional documents.

59. See, e.g., *Barger v. Comm'r*, 65 T.C. 925 (1976); *P.T. & L. Construction Co. v. Comm'r*, 63 T.C. 404 (1974).

60. See *Bernardo v. Comm'r*, 104 T.C. 677 (1995).

61. Treas. Reg. § 301.9000-2(b)(1) and (2). See *Shacket v. United States*, 339 F. Supp. 2d 1092 (S.D. Cal. 2004).

Role of IRS Counsel in Audits

Division Counsel

(1) Lawyers working in the local Division Counsel office for the auditing Operating Division usually will provide day-to-day legal advice to the auditor or audit team. LMSB Division Counsel automatically assigns a lawyer to each LMSB audit. Division Counsel lawyers also will assist the auditor or audit team if they seek advice from the National Office (i.e., CCA, TAM or TEAM).

(2) The auditor or audit team is not required to obtain or follow the Division Counsel lawyer's advice. Whether and to what extent an auditor or audit team seeks or follows Counsel's advice is similar to whether a private party follows its lawyer's advice. There are some major differences: the auditor does not select the lawyer and an issue will not be litigated unless the Chief Counsel supports the litigation.

Designation of Issue for Litigation

(1) The Operating Division may request (or Division Counsel may initiate a request) that the Chief Counsel designate an issue in a case for litigation. The taxpayer will be advised that an issue in its case is being considered for designation, and the taxpayer will be given the opportunity to explain why that issue should not be designated by the Chief Counsel. Once designated for litigation, an issue cannot be settled unless that designation is removed by the Chief Counsel. (Chief Counsel Desk Manual (CCDM) 35.3.14 states the process and standards for designating an issue for litigation.)

(2) One impact of designation of an issue is that Appeals cannot settle that issue in the taxpayer's case. Designation of an issue for litigation in one taxpayer's case, however, will not prevent Appeals from settling the same or a similar issue in another taxpayer's case. Comment: Chief Counsel normally would not seek to designate an issue for litigation once it has been the subject of settlement discussions in Appeals, and Appeals must agree to designation of an issue that is in Appeals' jurisdiction. Even though Fast Track Settlements are not within Appeals' jurisdiction, Chief Counsel likely would be reluctant to designate an issue in a case that is in this process.

Treasury/IRS Priority Guidance Plan (PGP)

The PGP lists the items on which Treasury/IRS expect to issue published guidance during the July-June period. NOTE: Check the PGP to determine if any potential issues (or issues raised in the audit) are the subject of projects under the PGP.

If an issue is the subject of a PGP project, the National Office may have an interest in the issue either (i) because the National Office will use the audit issue to develop guidance, or (ii) because the National Office will not want the audit issue (and possible resulting litigation) to impact the published guidance project.

Extensions (and Terminations) of the Statute of Limitations

Should we agree to extend the statute of limitations?

(1) Whether to extend the statute to allow the IRS to complete the audit, or to allow for Appeals consideration almost always is an issue.

(2) Pros: This improves the chances of settlement short of statutory notice and litigation, and potentially avoids a "box car" deficiency.

(3) Cons: This allows the IRS to continue to audit and find and develop issues, and potentially delays resolution.

What type of extension of the statute should we give?

(1) Specific extension to a specified date, on Form 872. The statute will not terminate before that date. NOTE: In many cases the IRS will request an extension on Form 872-I to avoid the expiration of the statute of limitation on partnership affected items.⁶²

(2) Open ended extension, on Form 872-A. The taxpayer can terminate upon notice (Form 872-T) and the limitations period terminates 90 days after notice.

62. See *Ginsburg v. Comm'r*, 127 T.C. NO. 5 (Aug. 30, 2006), holding that the statute of limitations on affected partnership items expired since the Form 872 signed by the taxpayer/partner did not expressly refer to partnership items.

Fast-Track Mediation or Settlement

SBSE Fast Track Mediation

Rev. Proc. 2003-41, 2003-1 C.B. 1047. This process is initiated before the 30-day letter is issued. The taxpayer and the IRS audit manager sign a mediation agreement. Appeals supplies the mediator, but an independent co-mediator may be involved by mutual consent at the taxpayer's expense. The mediator functions as a mediator and does not have Appeals settlement authority.

LMSB Fast Track Settlement

Rev. Proc. 2003-40, 2003-25 IRB 1044. The IRS Appeals officer acts as a mediator between taxpayer and LMSB. This program is optional for taxpayer and LMSB must agree. The process applies only to "fully developed" issues and resolves over 80% of issues in less than 120 days. If the issue does not settle, the Appeals officer may state on what basis he would resolve the issue but does not have settlement authority. If the issue does not settle in Fast Track, the taxpayer may pursue normal Appeals.

The IRS recently announced a two-year trial program to extend the LMSB Fast Track Settlement program to SBSE taxpayers. The program will differ slightly from LMSB's program.⁶³

Results of Audit and Closing

Notice of Proposed Adjustment

Form 5701 and 30-day letter. COMMENT: Sometimes the Agent will ask for the taxpayer's comments on a proposed adjustment prior to issuing the 30-day letter, which is also known as the Revenue Agent's Report (RAR). In some cases, it may be productive to comment to correct obvious errors, but such comments may merely allow the Agent to improve the quality of the adjustments and, thus, make settlement with Appeals more costly for the taxpayer.

Closing Conference

Agreed and unagreed issues should be identified and analyzed. Form 870 may be executed to resolve agreed issues. Form 870 is not a closing agreement, but does bind parties

under "estoppel" principles for issues resolved. (Form 870-AD, which is used to reflect settlements reached with Appeals, also is not a closing agreement, but may bind for all issues under estoppel principles.) See the discussion below of reopening of closed cases in Appeals.

Closing Agreement, I.R.C. § 7121.

- Closing Agreements under section 7121 are the only legally binding agreements between the IRS and taxpayers. There are basically two types of closing agreements, although a closing agreement may combine both types of agreement. Form 906 resolves only the specific matters covered by the agreement, and Form 866 resolves a taxpayer's tax liability for the year. If it is intended that a closing agreement resolve tax, penalties and interest, the agreement should specifically address those issues.
- Closing Agreements are final and conclusive as to matters covered, *except* upon a showing of fraud or malfeasance, or misrepresentation of a material fact.⁶⁴
- The procedural rules regarding closing agreements are at Treas. Reg. § 601.202.
- NOTE: It is important that the persons signing a Closing Agreement have authority to sign for the taxpayer and the IRS. The rules and delegations of authority that identify who can sign for the IRS are almost impossible to understand, so taxpayers in general have to rely on the IRS to identify the correct IRS person to sign.

III. APPEALS PROCEEDINGS⁶⁵

NOTE: Appeals settles about 90% of its cases.

64. Treas. Reg. § 301.7121-1.

65. (See generally, Treas. Reg. § 601.106)

63. See Ann. 2006-61, 2006-36 I.R.B. 1 (Aug. 22, 2006).

Pros and Cons of Pre-Deficiency Appeals Consideration

Limitations on Appeals Settlement Authority

Appeals Coordinated Issues

Special procedures apply to Appeals Coordinated Issues (ACI).⁶⁶ Any settlement of an ACI requires review and approval by the coordinating official. Appeals can settle coordinated issues based on hazards of litigation, but coordination assures a uniform approach to settlements.

Controlling Law

Adverse judicial or Revenue Ruling authority directly on point. See Treas. Reg. §§ 601.601(d)(2)(i)(a) and .601(d)(2)(v) regarding effect of a Revenue Ruling. But note that Appeals is not bound by a TAM or TEAM on an issue and may settle those issues based on litigation hazards.

ISP

Where the examination was part of an Industry Specialization Program and Counsel participated, the Appeals officer must use the ISP paper or coordinated issue paper to negotiate settlement and must obtain approval of settlement by the ISP coordinator.

Controlled Issues

Appeals officer cannot settle an Appeals "controlled" issue based on hazards of litigation. Controlled issues may be settled but only on an approved basis. Controlled issues are extremely rare.

Designation for Litigation

See the discussion above

Risk of New Issues/New Arguments

Standards for Raising New Issues

Appeals ordinarily will not raise a new issue unless:

- The Appeals officer is "quite certain" that the IRS will prevail if the issue is litigated⁶⁷

- The necessary facts to sustain the issue are readily available⁶⁸
- The amount of the tax liability is "material" in an absolute sense⁶⁹

New Arguments/Facts

Appeals may raise new arguments regarding the issues in the 30 day letter. Appeals also may determine that facts necessary to consider the issues have not been developed by the audit and may refer the case back to the Operating Division for further factual development, especially if the taxpayer submits new facts in the Appeals proceeding.

Requirement to Exhaust Administrative Remedies

Penalty

Tax Court may impose a penalty of up to \$25,000 if it determines that a taxpayer unreasonably failed to pursue available administrative remedies. I.R.C. § 6673. The purpose of section 6673 is to penalize taxpayers who bypass Appeals without good reason.

Recovery of Fees and Costs

A court must determine that a taxpayer has exhausted administrative remedies available to the taxpayer (including Appeals consideration) in order to award attorney's fees and costs.⁷⁰

Shift of Burden of Proof

The taxpayer may shift the burden of proof to the IRS only if the taxpayer exhausts all administrative remedies. I.R.C. § 7491.

(1) The shift of the burden of proof under section 7491 applies only if the taxpayer satisfies the net worth requirements (not more than \$7 million) of section 7430.

(2) In addition, the taxpayer must: (i) introduce credible evidence on the disputed fact issue; (ii) maintain all records required by the Code; (iii) comply with all substantiation requirements; (iv) establish the application of any asserted

66. Rev. Proc. 79-34, 1979-2 C.B. 498.

67. IRM 8.6.1.4.2.4.

68. IRM 8.6.1.4.2.6.

69. IRM 8.6.1.4.2.7-9.

70. I.R.C. § 7430(b)(1).

privileges; and (v) cooperate in the audit with all reasonable requests by the IRS for information.

Exhaust Administrative Remedies

(1) A taxpayer has exhausted administrative remedies only if (i) the taxpayer "participated" in an Appeals conference prior to filing suit, or (ii) the taxpayer requested an Appeals conference and that request was denied.⁷¹

(2) A taxpayer is not considered to have participated in an Appeals conference unless the taxpayer discloses all information the taxpayer knew or should have known was relevant at the time of the conference.⁷²

(3) A taxpayer is *not* required to extend the statute of limitations in order to "exhaust all administrative remedies".

Appeals Settlement Process

Taxpayer's Protest

When Required

A written protest is required for field examinations involving more than \$10,000 and in all employee plan, exempt organization, partnership and S corporation cases.⁷³ The auditor/audit team will review the Protest and submit a rebuttal with the transmittal to Appeals. NOTE: Taxpayer has a right to a copy of the auditor's rebuttal upon request. Some Appeals officers are irritated by this request.

Contents

Although no specific form is required, a typical protest includes:

- Name and taxpayer ID.
- Name, contact information and Form 2848 (Power of Attorney), if not previously filed, for taxpayer's representative.
- Statement that protest is timely filed and any extensions of time.
- Description of the deficiencies proposed by the 30 day letter and date and symbols of the letter.

71. *Burke v. Comm'r*, 73 T.C.M. (CCH) 2291 (1997).

72. Treas. Reg. 301.7430-1(b)(2).

73. Treas. Reg. § 601.105(d)(2), 601.106(a)(1)(iii).

- Description of the issues and amounts protested. (Also discuss any procedural oversights or irregularities.)
- Statement of taxpayer's position on each protested issue, including taxpayer's view on disputed facts and reference to any materials that taxpayer would like Appeals officer to consider.⁷⁴
- A request for a conference with the Appeals officer.
- A signed declaration by the taxpayer that the facts alleged are true under penalties of perjury. Alternatively, the taxpayer's representative must declare that the prepared the protest and whether he knows the facts to be true and correct. NOTE: Usually it is good practice to have the taxpayer rather than the representative sign the declaration.

Appeals Conference(s) and Settlements

Informal Conference

Appeals conferences and procedures are informal, but the taxpayer should be fully prepared and present the case completely and carefully. Treas. Reg. § 601.106(c) NOTE: The protest is very important. The Appeals officer may form strong views before the conference.

Rules of Practice in Appeals

(1) Circular 230 applies in Appeals proceedings, so practitioners should consider its impact.

(2) Appeals will determine the correct amount of tax with "strict impartiality" between the taxpayer and the Government.

(3) Appeals will settle a case based on the relative merits in light of the hazards of litigation.

(4) If the taxpayer makes a good faith offer to settle, Appeals should inform the taxpayer of the basis on which Appeals will settle. (This doesn't apply to "controlled" or "coordinated" issues.)

(5) Generally, if the Appeals officer recommends acceptance of the taxpayer's offer, but the reviewer disagrees, the taxpayer should be offered an opportunity to meet with the reviewer.

(6) If the Appeals officer agrees (and Examination desires) the auditor or audit team may attend Appeals conference(s).

74. Treas. Reg. § 601.106(b)(4)(ii).

(7) If the taxpayer presents evidence to the Appeals officer that it did not present to the auditor, Appeals may refer the case back to examination. The Appeals officer also may share any new evidence with the auditor.

(8) Division Counsel may request to attend an Appeals conference.⁷⁵

TAM from Appeals

(1) The Appeals officer may request a TAM, or request that the National Office revoke or modify a prior ruling or advice. (Normally, a request for a TAM should come from the auditor during examination.)

(2) The taxpayer may ask the Appeals officer to request a TAM on the basis that there is lack of uniformity as to disposition of an issue, which requires National Office consideration. The taxpayer can appeal denial of request for a TAM by submitting a statement explaining the reasons why the matter should be referred to National Office.

(3) A TAM favorable to the taxpayer (unless reconsidered) binds Appeals and normally is applied retroactively.

(4) A TAM unfavorable to a taxpayer normally applies retroactively (unless discretionary section 7805(b) relief is requested by taxpayer and granted by IRS). Appeals is not "bound" by a taxpayer unfavorable TAM, and may settle the issue or case under normal Appeals' criteria (i.e., hazards of litigation). Treas. Reg. § 601.106(f)(9).

No "Nuisance" Settlements

Appeals will not settle based on "nuisance" value.⁷⁶

(1) Nuisance value is sometimes defined as less than 20%, although nuisance value has been declining (15%-10%) as dollars increase.

(2) Nuisance value is a two-way street and Appeals also should not demand nuisance value settlements from taxpayers.

(3) Appeals officers evaluate each issue separately based on hazards. The taxpayer may weigh hazards differently on different issues and still settle based on overall result. NOTE: Some Appeals officers focus more on the dollars, while others are more concerned with the issues.

"Qualified Settlement Offer" pursuant to section 7430(c).

- If the issue ultimately is resolved for an amount equal to or less than a qualified offer, the taxpayer is treated as the "prevailing party."
- The "prevailing party" is entitled to recover administrative and litigation fees and costs under section 7430(c) even if it loses the issue.
- The taxpayer must identify the offer as a qualified offer.
- To recover fees and costs, the taxpayer must satisfy section 7430 net worth requirements.
- The taxpayer must exhaust administrative remedies to recover fees and costs.

Documenting the Settlement

- Form 870-AD: See the discussion below regarding when case closed in Appeals will be reopened.
- Closing Agreements - § 7121
- Partial Agreed - Notice of Deficiency

Rules Regarding Ex-Parte Communications⁷⁷

Appeals officers cannot have communications with the Operating Division regarding the substance of the taxpayer's matter without participation by the taxpayer or its representative. This applies to all oral or written communications.

Jurisdictional Issues: Exams, Appeals, Counsel

Settlement can be complicated where there are multiple years with same issue and different parts of the IRS have jurisdiction. It will be even more difficult if the Department of Justice is involved due to a pending refund suit.

Reopening Appeals Cases

A case closed by Appeals on the basis of concessions by both parties (a Form 870-AD) will not be reopened by the IRS in the absence of fraud, malfeasance, *concealment* or misrepresentation. NOTE: Except for "concealment," this is the same standard as applies to set aside a Closing Agreement. But, this is

75. Treas. Reg. § 601.106(f)(1)-(8).

76. Treas. Reg. § 601.106(f)(2).

77. Rev. Proc. 2000-43, 2000-43 IRB 1.

an administrative policy based on estoppel principles, since there is no contract between the taxpayer and the government.

A case closed by Appeals on a basis not involving concessions by both parties will not be reopened by the IRS in the absence of fraud, malfeasance, concealment or misrepresentation of material fact, an important calculation mistake, or other circumstance such that failure to reopen would be a serious administrative omission. NOTE: This is an administrative policy since there is no contract. There is no estoppel where there are no mutual concessions, so the IRS administrative standard to reopen is lower.

A case closed by Appeals on a basis not involving a concession by both Appeals and the taxpayer may be reopened by the taxpayer.⁷⁸ NOTE: This just states the law that in the absence of a Closing Agreement there is no contract, so in the absence of estoppel the taxpayer legally may reopen the case.

Early Referral to Appeals and Alternative Dispute Resolution Procedures

Early Referral of Issues to Appeals

A taxpayer may request that one or more fully developed "stand alone" issues in an audit be referred to Appeals prior to issuance of the 30 day letter.⁷⁹

Mediation

Where normal Appeals proceedings have failed, a taxpayer may request post-Appeals mediation.⁸⁰

Arbitration

A pilot program for post-Appeals arbitration ended June 30, 2003. See Ann. 2002-60, 2002-2 C.B. 28. The IRS has just announced a permanent arbitration process within Appeals that is available for unresolved factual issues (but not legal issues) following settlement discussions.⁸¹

IV. CONCLUSION

The following is a brief summary of the answers to the questions that taxpayers noticed for audit commonly ask:

- Why was I selected by the IRS for audit? Answer: We cannot say for sure, but you may know. If you don't know, then there likely was something about you or your return that prompted the audit.
- How long will this audit take? Answer: We cannot say for sure, but it likely will take longer than either of us thinks.
- Why do the agents want all this information, documents, data, etc.? Answer: We cannot say for sure, but in general they are following their procedures and they don't know what they don't know.
- Do I have to give the agents all the information, documents, data, etc. they have requested? Answer: We can negotiate, but if push comes to shove, you likely will have to provide what they have requested, except for privileged communications and work product. Objections based on relevance and materiality are rarely sustained by the courts.
- What can the IRS do if I don't cooperate in the audit? Answer: First, we cannot represent you if you are just going to refuse to comply with their proper and lawful requests. Second, you may subject yourself to penalties; you may lose your administrative appeal and other rights; and the IRS likely will determine a larger deficiency after a more intrusive audit.
- Can I recover from the IRS the fees and expenses I incur in the audit and in the Appeals proceeding? Answer: Yes, under limited circumstances if your net worth is less than \$7 million, you are the "prevailing party" and you exhaust your administrative remedies. You are a "prevailing party" only if (i) you prevail on the merits and the IRS position was not substantially justified, or (ii) you make a "qualified offer" to settle your liability, that offer is not accepted, and the issue is resolved on a basis equal to or less than your offer.
- Should I ask for an Appeals conference? Answer: Well, that depends. Normally, yes, but there are situations where the taxpayer should just go to court and not waste the time and expense, or run the risk of new issues being raised.

78. Treas. Reg. § 601.106(h).

79. I.R.C. § 7123(a); Rev. Proc. 99-28, 1999-2 C.B. 109.

80. I.R.C. § 7123(b)(1); Rev. Proc. 2002-44, 2002-2B IRB 10.

81. Rev. Proc. 2006-44, 2006-44 I.R.B. 800.